



The Effects of the Audit Committee Independence and Expertise on Firms' Value, an Empirical Study on Palestine Empirical Study on Palestine

Mohammed Azam (Corresponding Author)

School of Accounting, Dongbei University of Finance and Economics, Dalian, Liaoning, China

Email: mazzam1988@gmail.com

Man Wang

School of Accounting, Dongbei University of Finance and Economics, Dalian, Liaoning, China

Email: manwang@dufe.edu.cn

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Abstract

This study examined the influence of the characteristics of the audit committee on Palestinian firms' value. The research explores precisely the effect on the Audit Committee characteristics' efficiency, namely, independence, expertise, evaluating the relationship among dependent and independent variables. Secondary data collected from a list of companies were registered in the Palestine Stock Exchange from 2011 to 2018. Individual variables considered are the independence & expertise of the audit committee, whereas the ROA is employed as the dependent variable as an indicator of a firm's value. The results showed that the Audit Committee's independence & expertise substantially positive with ROA. The study concluded that the audit committee's characteristics are enhancing firm performance. The implications of this study's findings can be used by decisions and policymakers, the firm's management, and other stockholders' interests to create reliable ties between agents and the principals.

Keywords: Audit committee independence; Expertise; PSE; Firm value; Palestine.

1. Introduction

In the meantime, sub-board committees are set up and appointed with a role for the same attempt to enhance board governance. The Audit Committee is an instance of this. As set out in the Code of Corporate Governance, the audit committee is responsible for evaluating firm financial procedures and the company's financial position (Saar *et al.*, 2012). The Audit Committee also monitors internal control procedures to ensure that codes are properly respected (Gendron *et al.*, 2004). About external audits, the committee must nominate and mediate an external auditor and management to ensure that external auditors are terminated (Gibbins *et al.*, 2010).

The audit committee must be impartial to carry out an efficient supervision and pay greater attention to information (Abbott *et al.*, 2000). Research shows that the external committee director's involvement strengthens the committee's objectivity (Be' dard *et al.*, 2004). Audit committee proactivity would further enhance corporate governance, safeguard shareholders, and reduce the imbalance of asset pillage and information (Turley and Zaman, 2004). As a result, company efficiency is increased by enhancing the Board's oversight and decreased information asymmetry through the participation of an efficient committee. This also alleviates the dilemma of the Department as the audit committee requests that the details be duly disclosed (Gibbins *et al.*, 2010). The following research question is directly addressed by this study:

Different financial irregularities place greater liability on the board. Those financial irregularities raised concerns about the audit committee's monitoring efficacy in conflict resolution (Ebrahim, 2007). The principle suggests that the audit committee should uphold the credibility of financial statements. Access to financial irregular reports is also the responsibility of the audit committee (Klein, 2002). The audit committee plays a crucial role in strengthening coordination gaps and reducing the inconsistencies between the management and the external auditor. The action of the monitoring management therefore expects to constrain future exploitation and supplies the necessary information to the external auditor.

The connection between the financial report and the audit committee currently has contradictory analytical findings. Companies that create and audit committee should generate accurate financial reports in compliance with the postulation agency and some empirical findings. The independence of the Audit Committee has been found by Carcello and Neal (2000) to decrease the likelihood that auditors report. The Rezaee *et al.* (2003) results, however, indicate that otherwise. In the creation of the Audit Committee, his results do not boost financial information reliability.

In a country like Palestine, the need for research on the relation between audit committee and business performance is significant. This is due to efforts by the country in seeking structures of corporate governance that boost corporate performance and thus draw more foreign investment. There are very few papers still available on the

study, considering the various reports on the audit committee and firm achievements in Iraq. The following subheadings address the factors defining the efficacy of the audit committee in previous studies.

2. Literature Review and Hypothesis Development

Audit committees are responsible for oversight. The supervisory role of the audit committee is made more successful when the Committee, management and the Board of Directors have a working relationship (IIA Institute of Internal Auditors, 2009). Apparently, the audit committee's supervisory role as a sub-committee of the board deals with financial statements. As they control the board and give them added assurance, their presence is also very important. An audit committee's key role is to assist in resolving conflicts of interests between the board and the management. If you comply perfectly with the Corporate governance code, the result would be favourable. A well-defined position, skilled staff and professionalism are important factors that improve the audit committee's efficiency. Moreover, coordination between the audit committee, the board, the external and internal auditors would enhance the effectiveness of the audit committee.

Prior literature analysed the relationship between audit committee and firms value. Puni (2015) A sample of the Ghana Stock Exchange from 2006 to 2010 examined and identified the positive correlation between ROA, ROE and the audit committee life. The analysis of the different role of auditing boards on management was analyzed by Ghafran and O'Sullivan (2013). The results of the audit committee on the stock market response indicate that investors trust the setting up of audit committees. Beasley *et al.* (2009) It claimed that in relation to the establishment of the audit committee is the high reporting framework. In addition, from 2010 to 2011, the analysis of 80 companies listed on the Karachi Stock Exchange was conducted by Muhammad *et al.* (2016). The study established a positive relationship with firm performance using ROA and ROO as metrics between the presence of the audit committee.

In Bangladesh, Rouf (2012) the relationship between firm value in the Dhaka Stock Exchange has been studied (measured via ROE and ROA), the presence of an audit committee using 93 listed non-financial firms, and a significant relationship has been established. In other words, between 2006 and 2007 Bremert and Schulten (2008) investigated 160 listed German companies and found a negative relationship between firm results and the existence of the Audit Committee by using ROA and Tobin's Q as indicators.

The content of the financial statements of any company can only be accepted on the basis of certain claims put forth by the previous investigations if the audit committee exists. This is supported by the Agency's hypothesis by referring the committee as another internal management tool. Table 1 thus summarizes the findings of the empirical studies discussed above about the relationship between company success and the existence of the audit committee.

2.1. Audit Committee Independence

In separate corporate ownership and the problem of agency conflicts in monitoring performance, an efficient audit committee is needed as part of the corporate process. The Board consists of an audit committee that functions actively for the sake of corporate governance. The independence of the audit committee is a crucial problem in previous studies. Under these literatures, the audit committee enhances reporting independently of the audit committee (Lin *et al.*, 2006). As stated under the Corporate Governance Code, the Audit Committee makes an important contribution to ensuring that corporate values are essential because of the independence and professional actions of the committee members. A combined sample from Singapore and Malaysia was used by Bradbury *et al.* (2006) to analyze the correlation between accounting quality and the composition of the audit committee. The results of the study indicate that the independence of the audit committee increases earnings efficiency.

The relation between independence of the audit board and firm performance was recently investigated by Hamdan *et al.* (2013) on the list of stock exchange companies in Amman. The audit committee's independence enhances the company's efficiency. The audit committee's position affect the performance of the ROA and ROE performance proxies on a sample of Tunisia-listed firms from 2007 to 2010, according to Bouaziz and Triki (2012). The audit committee's independence has been shown in relation to the success of businesses. The independence of the audit committee and the financial results of Oman are significantly positive (Al-Matari *et al.*, 2014).

Conversely, no connection exists between the independence of the audit committee and the financial results of Indian companies (Bansal and Sharma, 2016). On the contrary, as reported by Robin and Amran (2016), there are negative links between independent audit committee and firm performance (2016). The analysis was carried out in 122 Indonesia Stock Exchange family-owned listed companies between 2010 and 2014. There is also a negative relationship between Dar *et al.* (2011) from Pakistan. Wakaba (2014), found in Kenya that the audit committee has a negative correlation with the company's results.

The independence of the manager would thus assist them to reduce their credibility and offer a quality corporate decision. The independence of the Audit Committee from the point of view of Palestine would allow the members to determine their financial reporting policy, the external audit process, the auditor's independence and the financial condition of the company in an objective and impartial manner we thus hypothesis the following hypothesis:

H1: Audit committee independence positively affect firm's value.

2.2. Audit Committee Expertise

Themes that bother about the efficacy of the audit committee have increased in recent years, based on committee members' expertise and knowledge. The Board of Directors' duty shall ensure that the financial statement

is accurate and valid in order to ensure that stakeholders can properly evaluate the financial situation (Hamid *et al.*, 2015). Delegates from the board of directors are responsible for supervising the management's financial statements to the audit committee. According to Bradbury (1990), by introducing a sound management structure, both internally and externally, the integrity of the financial reporting process is improved by the audit committee. Most citizens have a proper understanding of and knowledge of financial statements to preserve the integrity of the financial reporting standards and to track the financial reporting system effectively.

Recently, regulatory initiatives have made arrangements requiring the member to hold at least one financial competence to enhance the efficiency of the audit committee. Awareness of the audit committee should cover all other areas of the company's operation in excess of accounting and auditing knowledge. The right question can be asked and the management scrutinized with such a knowledge and understanding of the activities of the organization. In several ways, previous research explored the financial expertise of the audit committee as one of the core features of an efficient committee.

The relationship between management supervision, audit committee financial experience and financial report method was investigated in comprehensive studies. There are many empirical findings which support the fact that a financially stable audit committee enhances the quality of the figures (Abbott *et al.*, 2002). DeFond *et al.* (2005) Empirical results show the positive impacts of investor response on the appointment to audit committee of representatives with financial experience relevant to accounting skills. Regarding financial reporting, a study showed that financial expert audit committee reduced the vigorous reporting process (Be' dard *et al.*, 2004; Dhaliwal *et al.*, 2006). Zhang *et al.* (2007) companies with internally poor control have stated the members have less financial and non-financial experience. The relation between the audit committee's financial competence and their independence was investigated by Mustafa and Ben Youssef (2010). They stated that the misappropriation of the assets reduced by independent directors with financial expertise. Abernathy *et al.* (2014) further research showed that accounting knowledge is connected to reducing the latency of financial reporting. It also indicates that the audit committee's accounting expertise enhances the efficacy of the audit committee.

The relationships between the audit committee and expert and firm achievement were reported in Malaysia by Rashidah and Fairuzana (2006) to be positive. In addition, Zájbojníková (2016) analyzed the relationship of experience and skills in the audit committee and firm success by ROE steps process. In the London Stock Exchange list 72 British companies were chosen. The study shows that the awareness and experience of the audit committee is optimistic about firm results (ROE). Similarly, there has been a positive correlation among the expertise and expert and firm success of Ojeka *et al.* (2014), Wakaba (2014), and Amer (2016).

However, the relationship between the expertise of the audit committee and the expert and the company performances was considered negative by Glover-Akpey and Azembila (2016). In 2015, 36 of the listed companies in Ghana were considered by Glover-Akpey and Azembila (2016). For the audit committee expertise, experts and firm results the study found a negative financial expert partnership.

In their studies, Hamdan *et al.* (2013) both reported positive ROE and EPS and not important ROA and Tobin's Q. Gunes and Atilgan (2016) studied ten Turkish banks and ten UK banks from 2006 to 2010. The research showed that the correlation between expertise and firm performance in the audit committee is negative in Turkish banks but not substantial in the case of ROE-compliance with UK banks.

Consequently, the experience and skills of the audit committee are important in order to ensure active involvement in the evaluation of the appropriateness of management accounting. This research considers this variable to be significant, given the unfinished association between the expertise and the audit committee and the firm value of previous studies we consider the following hypothesis.

H2: Audit committee independence positively affect firm's value.

3. Research Design

3.1. Sample Selection and Data Collection

The data gathered from two sources that are companies' annual financial statements listed in Palestine Stock Exchange Market (<http://www.pex.ps>) and OSIRIS database of financial information. Firms' annual reports are used to collect manually the the number of independent and expertise members of audit committee.

All companies listed on the Palestinian Stock Exchange market are non-financial companies. However, the financial firms listed (banks and insurance companies) are omitted, as they comply with some laws and regulations. Consequently the research population is 34 non-financial listed undertakings, as shown in Table 1, covering the manufacturing, investing and service sectors from 2011 to 2018 We exclude missing value-added company-years, as well as negative and null before-tax revenue observations that result in final results 278 company-year observations.

Table-1. Industry classification

Sector	No. firms	Percent
Service	12	35.3
Industry	13	38.2
Investment	9	26.4
Total	34	100

3.2. Variable Measurements

3.2.1. The Dependent Variable (Firm value)

ROA is used as measures for profitability in a corporation. *Latif et al. (2013)*, have reported that ROA would be used to calculate the net income divided into total assets by year-end. ROA gives an example of how efficient management in assets is used to provide revenue. The calculation of ROA is by calculated by dividing the annual earning of the firm by its total asset. In this case percentage is used to measure ROA.

$$ROA_{it} = \text{Net income}_{it} / \text{Total Assets}_{it}$$

3.3. The Independent Variables

3.3.1. Audit Committee Independence

The number of Qualified Non-Executive Directors on the audit committee considered to be independent member as stated in *Nawafly and Alarussi (2016)*; *Hamdan et al. (2013)*; *Bouaziz and Triki (2012)*; *Robin and Amran (2016)*.

3.4. Audit Committee Expertise

Audit committee expertise of the Audit Committee measures the amount of financial experience of the audit committee (*Hamdan et al., 2013*; *Nawafly and Alarussi, 2016*; *Ojeka et al., 2014*; *Wakaba, 2014*).

4. Econometric Specification

To test our hypotheses, we specify the following ordinary least squares (OLS) regression model:

$$ROA_{it} = \alpha_0 + \alpha_1 ACINDE_{it} + \alpha_2 ACEXP_{it} + \alpha_3 INDTYP_{it} + \alpha_4 LEVERG_{it} + \alpha_5 YEAR4_{it} + e$$

Where **ACINDE** audit committee independence and **ACEXP** audit committee experience, We also used control variables that could affect companies proprieties, regarding to audit committee independence & expertise, **LEVERG** is the percentage of total long-term debts over total assets. *Badertscher et al. (2013)* resulted a positive relationship between leverage and effects of audit committee cherecterestics. **INDTYP** it dummy variable; representing three industry types "manufacturing, investment, and service sectors.

5. Results and Analysis

5.1. Descriptive Statistics

The summary statistics of our dependent and independent variables are listed in *Table (2)*. The mean ROA is .0155, while the mean values are .132 and .1629 percent for ACIND and ACEXP, respectively. Compared to those stated by *Bouaziz and Triki (2012)* and *Tornyeva and Wereko (2012)*, these findings indicate a fair effects of audic committee characteristics. The level of independence and experience of the audit committee differs significantly among our firms sampled. ACEXP, the lowest stage of ACIND, is .010 and .019 respectively.

Table-2. Descriptive statistics

Variables	Mean	SD	Minimum	Maximum
ROA	.015	.0192	-.52	.2015
ACINDE	.129	.2345	.011	.152
ACEXP	.159	.1796	.018	.1625
LEVERG	.1239	.1996	0	.823
INDTYP	.273	0.2539	0	1

Notes: *Table 2* provides informative statistics for a targeted sample of 34 Palestinian companies listed on the Palestinian stock exchange market, ROA of profits before tax scaled by total assets ACEXP is the number of committee members with accounting certificates, ACINDEP determined by the number of members of the audit committee who are not members of the board, LEVERG is the ratio of total long-term debts

5.2. Correlation Matrix

The Pearson correlation between variables used in empirical regressions is presented in *Table 3*. We find ROA and **ACINDE** and **ACEXP** correlating significantly, and we have tested multicollinearity among independent variables with the regression model, the correlation between independent variables and VIFs to test the multicollinearity of *Table 4*, VIF range from 1.05 to 1.79 below 10 (*Neter, 1996*).

Table-3. Spearman correlation matrix

	ROA	ETR1	ETR1	LEVERG	INDUS
ROA	1				
ACINDE	0.676***	1			
ACEXP	0.0757*	0.176***	1		
LEVERG	-0.0130*	-0.0135*	-0.162***	1	
INDUS	-0.0672	0.0631*	-0.0608	-0.132**	1

Note: ROA is of income before tax scaled by total assets ACINDEP and ACEXP are audit committee independence and experienced members, , LEVER is the ratio of total long-term debts over total assets, INDTYP it dummy variable; representing three industry types "manufacturing, investment, and service sectors. ;***,**,*are significance levels at 1,5 and 10%, respectively

5.3. Multivariate Analysis

Table 4 illustrates the results of the audit committee independence ACINDE, ACEXP on ROA, we can observe positive and statistically significant relationship firm value and audit committee independence and expertise. Table 4 suggest that this results support hypothesis of positive relationship between audit committee independence, expertise and firm value. Tornyeva and Wereko (2012) and Bouaziz and Triki (2012), Al-Matari et al. (2014) Table 4, with the control variables shows that companies with increased business types appear to promote less audit committees' dependency, shows the positive relationships between corporate value and the audit Committee independence and experience. LEVERG has reported positive ties between the independence of the leverage and audit committee and expertise, in accordance with Badertscher et al. (2013).

Table-4. Shows the results of multiple regression analysis using ROA dependent variable

Variables	Predicted sign	Coef	T-value	Sig	VIF
Intercept		-7.4	-0.73	.465	
Independent variables					
ACINDE	-	0.31166**	-1.93	0.055	1.79
ACEXP	+	.3618*	-1.87	0.063	1.54
LEVERG	-	0.0129**	0.42	0.0672	1.09
INDUS	-	.5435	-0.27	0.787	1.05
Observations	278				
Adjusted R-squared	.39				
F-test.	21.40				
Prob > F	.000				

Note : Table 4 report regression results using OLS, ACINDE is calculated by the number of independent members ROA is of income before tax scaled by total assets, LEVERG is the ratio of total long-term debts over total assets, INDUS it dummy variable; representing three industry types "manufacturing, investment, and service sectors. ;***,**,* are significance levels at 1,5 and 10%, respectively

6. Conclusion

This study explores the impact of the competence and independence of the audit Committee on firm value. In terms of the important market value, we are seeing a positive relationship between firm principles and independence & the experience of the Audit Committee on the basis of a sample of 34 Palestinian listed companies during 2011 to 2018. Our findings are important in the Palestinian context, which considered exceptional because of the poor security of investor rights. In addition, the stock market in Palestine has not adequately grown. This study has spotlight on audit committee efficiency on unique environment in Palestine and thus extend literature that focused on developed countries. Simultaneously, considered as basis in Palestine and other Arab countries for future research in this area.

Although there are still restrictions on the last consequences of this analysis, one sample is restricted. However, the study encourages the researchers to undertake research into corporate governance in Palestinian and Middle East States to better understand the correlation of successful corporate management to other business variables, since the Palestinian exchange market has few listed companies, as small countries with precarious political circumstances.

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